liable under the second. If the directors were liable for such payments, the stockholders would receive the benefit of their liability by having the *surplus available for dividends* restored to the former amount, and thereby have an additional source of funds for future dividends.

While a dividends out of other than earned surplus without notice to the stockholders, comes under a literal interpretation of the directors' liability under sec. 8623-123b, yet because of the difference in interests protected, it would seem that the directors should not be liable under that section for failure to give notice as provided in sec. 8625-38 (paragraphs *d* and *e*).

F. F. V.

Purchase of Own Shares By Corporation—Fund Available

Proceeding under Ohio G. C. Sec. 8623-14, the defendant corporation, by a two-thirds vote of its shareholders, amended its articles of incorporation so as to relieve it from the obligation of maintaining a sinking fund for the redemption of preferred shares. Plaintiffs, minority shareholders who had voted their shares against the amendment, took advantage of the "appraisal statute," Sec. 8623-72, and demanded that the corporation pay them the "full cash value" for their shares. The corporation refused to pay the price asked, and made a counter offer. Rejecting this, plaintiffs brought suit in the Common Pleas Court of Franklin County to determine the fair cash value and secure a judgment against the corporation. The court sustained a motion to dismiss for failure of proof. Plaintiffs appealed, and following the Court of Appeals order reversing the

[10] It may be argued that the corporation is the stockholders and that therefore the same interest is being protected by both sections of the act. But the interest of the stockholders as an aggregate may well be different from the interest of the individual stockholder. As for example, if dividends out of other than earned surplus are paid to preferred stockholders, does failure to give notice to the preferred stockholders injure the common stockholders when if notice were given to the preferred, the common stockholders would not have cause to complain even though he was kept in ignorance of the payment? If the preferred stock has preference on dissolution, the preference is the full definition of the preferred stock's rights, and precludes the preferred from sharing in the surplus available after payment of par on the preferred and common. Williams v. Renshaw,220 App. Div. 39, 220 N. Y. S. 532 (1927); Murphy v. Richardson Dry Goods Co., 326 Mo. 1, 31 S. W. (2d) 72 (1930). The preferred stockholder therefore does not have the interest in keeping the capital surplus intact that the common stockholders would, and yet in our example the notice if given of the payment out of capital surplus would be to him. The notice seems therefore not for the protection of the aggregate of the stockholders, but only for the stockholder in his individual capacity.

judgment of the trial court and remanding the cause, the defendant sought a reversal of the judgment of the Court of Appeals in the Ohio State Supreme Court. In affirming the order, the Supreme Court held that "Sec. 8623-41 General Code, forbids the purchase of shares from dissenting shareholders *only* when there is reasonable ground for believing that such purchase would leave the corporation with assets of less value than the aggregate of its liabilities to creditors." [1]

Sec. 8623-41 authorizes the purchase by a corporation of its own shares in certain instances, and also prescribes definite limitations on this power to purchase.[2] It is unfortunate that this section contains no clear statement as to the funds that may be used for such purchases, as does Sec. 8623-38, in respect to dividends.[3] Paragraph 2 of subdivision (9), Sec. 41, is a provision added by the amendments to the General Corporation Act, effective July 24, 1939, to prohibit treasury shares from being considered as assets in the determination of a surplus available for dividend payments, stock purchases, or other distribution. In an article discussing the 1939 amendments,[4] Professor Lattin observed that under old Sec. 41 it was arguable that, except in the purchase of its own shares under subdivision (c),[5] shares could be purchased out of capital, as

[1] Wildermuth v. The Lorain Coal and Dock Co., 138 Ohio St. 1, 32 N. E. (2d) 413 (1941).

[2] Ohio Gen. Code Sec. 8623-41 (all but relevant provisions paraphrased)—A corporation may purchase its own shares: (1) When articles authorize redemption (2) To collect or compromise debt or unpaid subscription (3) For sale to employees under Sec. 8623-36 (4) From employees, under repurchase agreement (5) To eliminate fractional shares (6) Where articles give corporation a preemptive right (7) From dissenting shareholders (8) "To the extent of the surplus of the aggregate of its assets over the aggregate of its liabilities plus stated capital, when authorized by the affirmative vote of the holders of two-thirds of each class of shares outstanding, regardless of limitations or restrictions on the voting power of any such class, or if the articles so provide or permit, a greater or lesser proportion, not less than a majority, of the shares of such class, or by the board of directors when authorized by the articles." (9) Paragraph 1: For the reduction of stated capital; Paragraph 2: "In the determination of the excess of a corporation's assets over its liabilities plus stated capital, for the purpose of declaring and paying a dividend, purchasing its own shares or making any other distribution to shareholders, treasury shares shall not be considered as an asset of the corporation." Paragraph 3: "A corporation shall not purchase its own shares except as provided in this section, nor when there is reasonable ground for believing that the corporation is unable, or by such purchase may be rendered unable, to satisfy its obligations and liabilities." Paragraph 4: Limitation on purchase of shares by a subsidiary.

[3] G. C. sec. 8623-38 (a): "A corporation may declare dividends . . . out of the excess of the aggregate of its assets . . . over the aggregate of its liabilities plus stated capital."

[4] Lattin, *Streamlining the Ohio Corporation—The 1939 Amendments,* (1940) 6 O. S. L. J. 123, 135, 136.

[5] Subdivision (c) is the only subdivision in the old statute that says anything about purchasing out of a surplus from which a dividend might have been declared.

in Massachusetts and Wisconsin.[6] He went on to pose the question: "Does the addition of this new paragraph have the effect of requiring that in all cases of purchases authorized under Sec. 8623-41, the stated capital must be considered as a liability to be deducted along with other liabilities from the total assets?" He concludes that from the position of this new paragraph in the section, it seems reasonable to believe that a purchase by a corporation of its own shares cannot be made out of any fund short of a surplus as defined in subdivision (8) of Sec. 41.

To pursue this argument a little further, what significance can be attached to the position of subdivision (9), paragraph 2? Its declared purpose is to prohibit treasury shares from being considered as assets in the determination of an excess available for dividend payments, stock purchases, and other distributions to shareholders, such excess to be "of assets over liabilities plus stated capital." It relates no more to the subject matter of subdivision (9), paragraph 1, than it does to that of the eight preceding subdivisions. If its prohibition was meant to be observed solely when a purchase is made under subdivision (8), as a gloss on that provision, then why was it not included within the body of that subdivision? Why, if that was the intention, was its language not consistent with that of subdivision (8) and the term "surplus" used instead of "excess"? And again, if it was to have such limited application in cases arising under Sec. 41, why does it refer to dividend payments and other distributions not taken care of by Sec. 41? Paragraph 2 is the only indication in the whole General Corporation Act of a *fund* from which stock purchases may be made. Paragraph 3 is the only other provision limiting purchases, and it prescribes a condition the existence of which will warrant a prohibition of share purchases, but does not point to a proper specific fund. Observance of the restriction imposed by that provision will, of course, effectively guarantee the maintenance of assets equivalent to obligations and liabilities, and in that general sense, paragraph 3 does indicate a "fund." But it may well be intended to cover situations such as where a corporation *has* an excess of assets over obligations and liabilities, including stated capital, but the purchase of its own stock would seriously impair its working capital.

[6] In commenting on old subdivision (b) of Sec. 41 George S. Hills in 48 HARV. L. REV. 1334, 1371 note 63 states: "Provision should be made to facilitate claims by or against the corporation, but it does not seem advisable to authorize the acquisition of shares out of stated capital for that purpose as permitted by . . . Ohio sec. 41 (b) . . ."

The casual reader of Sec. 41 might perhaps notice the conflict which is latent in a comparison of paragraphs 2 and 3 of subdivision (9). An attorney for a corporation intending to take action under this section might well be put to considerable time and effort to resolve the ambiguity which faulty draftsmanship has created.

In discussing Sec. 41 in the principal case[7] the court gave no consideration at all to this possible effect of subdivision (9), paragraph 2. Nor was the argument raised by brief of counsel for the corporation.[8] Construing subdivision (9), paragraph 3 the court said, "The last above-quoted paragraph . . . refers to insolvency: that is, when there is reasonable ground for believing that the corporation will not have sufficient assets to pay its liabilities to creditors, *not shareholders.*" In other words, so long as a corporation is solvent, i. e., has assets exceeding its liabilities *not including stated capital,* it may purchase shares of its own stock to the extent of that excess, for any of the purposes set forth in (1) to (7), inclusive, of Sec. 8623-41.

As stated previously, paragraph 2 is in such a position that it might reasonably be construed to be a prescription of the sole fund out of which purchases under Sec. 41 can be made. The December 16, 1938, *Report of the Ohio State Bar Association Committee on Corporation Law,* with respect to the proposed amendments, sheds a different light on the meaning of this section, however.[9] In the tentative amended draft of Sec. 41 included in that report, subdivision (8) was worded practically the same as it now reads.[10] This provision followed: "Shares may be acquired either out of stated capital or surplus under subdivisions (1) to (7), inclusive, of this section. Purchases from surplus under subdivision (8) of this section are not limited to purchases authorized by subdivisions (1) to (7) inclusive of this section." The comment appended to this tentative draft stated that the principal proposed changes are: ". . . (4) The inclusion of a provision to make it clear that purchases under subdivisions (1) to (7) inclusive may be made out of stated capital as well as out of surplus." This statement, in addition to supplying an unequivocal answer to the question previously posed, indicates

[7] 138 Ohio St. 1, 16, 17, 32 N. E. (2d) 413, 420, 421 (1941).
[8] Brief of Defendant-Appellant, Case No. 28282.
[9] At pp. 39, 40.
[10] *Ibid.* page 33. As there stated, subdivision (8) included a proviso (since deleted) prohibiting the purchase of stock out of a surplus created from retirement of treasury shares.

that the committee appreciated the need for such a clarification. In its report of December 26, 1938, the committee made no mention, either in the draft of Sec. 41 therein appearing,[11] or in the appended comments, of this proposed amendment. An attempt to explain the omission would be but conjecture. Needless to say, the final draft as passed by the legislature did not include such an illuminating provision.

Prior to the advent of legislative controls on the power of a corporation to purchase its own stock, the law of this country as to the problem was unsettled. Ohio followed what must be considered the minority rule, denying the existence of such a power in the absence of specific statutory authority or special circumstances.[12] This view was based upon the ground that a corporation possessed no powers except such as were conferred upon it by statute or necessarily implied therefrom. However, courts were not adverse to recognizing that such purchases would sometimes have to be made to avoid a loss or to satisfy a debt due the corporation.[13] Later authority can be found for the proposition that inasmuch as no constitutional or statutory prohibition against such a power exists, a purchase will not be set aside in the absence of a showing of bad faith and an injury to creditors.[14] The writer of the opinions in these cases representing a departure from the Ohio rule were consistent in their reluctance to discuss or point to a fund out of which the consideration for the purchase could be drawn.[15] But lack of a judicial rule in regard to this problem does not explain the legislature's failure to include one, in view of the comprehensiveness of the Ohio Act.

An inspection of the legislative restrictions imposed in other states indicates that the Ohio draftsmen were not alone guilty of creating ambiguous provisions. Many of these statutes have the effect of limiting stock purchases to instances where a "surplus"

[11] At pp. 41, 42.

[12] State *ex rel* Colburn v. The Oberlin Bldg. and Loan Assoc., 35 Ohio St. 258 (1879): Coppin v. Greenlees and Ransom Co., 38 O. S. 275, 43 Am. Rep. 425 (1882).

[13] Taylor v. Miami Exporting Co., 6 Ohio 177 (1833); Morgan v. Lewis, 46 O. S. 1, 17 N. E. 558 (1888); Merchant's National Bank v. Overman Carriage Co., 17 Ohio C. C. 253, 9 Ohio C. D. 738 (1898).

[14] Siders v. The Gem City Concrete Co., 13 Ohio C. C. (N. S.) 481, 23 Ohio C. D. 552 (1910); aff'd without opinion in 87 Ohio St. 519, 102 N. E. 1124 (1913).

[15] The opinion in the *Siders* case, *Supra* Note 14, devoted some attention to the evidence of the solvency of the corporation, but came to no conclusion as to a proper fund.

exists.[16] The term "surplus" might well be taken to mean (a) "earned surplus", that which has been earned through corporate activity and not distributed as dividends or reserved for other purposes; (b) "capital surplus", that which has arisen from the sale of stock at a premium, from the acquisition of its own stock at less than par value and from sale of capital assets at a sum greater than their stated value; or (c) "paid-in surplus," a contribution made by the purchasers over and above that part of the purchase price which must be entered on the books as capital.[17] Other statutes prohibit purchases where such would cause "any impairment of capital." [18] This indefinite phraseology was held by the Colorado Supreme Court not to limit purchases to surplus funds.[19] Other statutes speak of surpluses with more particularity. California Civil Code, Sec. 342, limits purchases to earned surplus except in certain instances; Minnesota Business Corporation Act, Sec. 7492-21, makes provision for purchases out of paid-in surplus and earned surplus, provided that if there be outstanding shares entitled to preferential dividends or to a preference on liquidation, then "only such shares shall be purchased or redeemed out of paid-in surplus." Illinois limits purchases to earned surplus, but the limitations do not apply when the purpose of the acquisition is to eliminate fractional shares, collect or compromise a debt, buy shares of dissenters or redeem shares as otherwise permitted by the act.[20]

[16] N. Y. PENAL LAW, (Bender, 1929), Sec. 664-(5) imposing criminal liability on corporate officers responsible for purchase of stock out of anything but a surplus; ILL. ANN. STAT. (SMITH HURD, 1935). Chap. 32, Sec. 157-6; LA. GEN. STAT. ANN. (DART. 1932) Sec. 1103; TENN. CODE ANN. (WILLIAMS, 1934) Sec. 3722 (9); W. VA. CODE (MICHIE, 1932) Sec. 3051; FLA. COMP. GEN. LAWS (1927) Sec. 6534 (3).

[17] *See* BERLE AND MEANS, THE MODERN CORPORATION AND PRIVATE PROPERTY (1933) at 102, BALLANTINE AND LATTIN, CASES AND MATERIALS ON CORPORATIONS (1939), note at 452; also Horowitz and Good, *May A Corporation Purchase Its Own Stock Out of Capital: The Problem Revisited,* (1938) 27 GEORGETOWN L. JOUR. 217.

[18] COLO. SAT. ANN. (1935) Chap. 41, Sec. 24; RHODE ISLAND GEN. LAWS (1938) Chap 116, Art. I, Sec. 5 (g); DEL. REV. CODE (1935) Corporations, Art. 1, Sec. 19; MICH. STAT. ANN. (1935) Sec. 21.10; NEV. COMP. LAWS (HILLYER, 1929), Sec. 1608 (3); IND. STAT. ANN. (BURNS, 1933) Sec. 25-202.

[19] Colorado Industrial Loan and Investment Co. v. Clem, 82 Colo. 399, 260 Pac. 1019 (1927).

[20] ILLINOIS ANN. STAT. (SMITH HURD, 1935) Sec. 157.6: "A corporation shall have power to purchase its own shares . . . provided it shall not purchase . . . when net assets are less than the sum of its stated capital, its paid in surprus, and (capital) surplus . . . or when by so doing its net assets would be reduced below such sum."

See Hills, *Model Corporation Act,* (1935) 48 HARV. L. REV. 1334, 1370, 1371, 1372. Mr. Hills regards earned surplus as the "most suitable and least restricted fund available for acquisition of shares", but recognizes that to give the rights of dissenters any practical value, purchases from such shareholders should not be restricted to such a surplus.

Also see Levy, *Purchase by a Corporation of Its Own Shares,* (1930) 15 Minn. L. Rev. 1, 37, and note at 20.

Paradoxically, the Uniform Business Corporation Act contains no provision in regard to this problem.

By the doctrine prevailing in Massachusetts and Wisconsin, in the absence of express statutory restrictions, corporations may purchase their own shares in good faith out of capital, provided this is done without prejudice to rights of existing creditors or discrimination against other shareholders.[21] Seemingly, the decision of the *Wildermuth* case is in accord with this general policy, and completes the anomolous metamorphosis through which the Ohio law has passed. Time forbids a discussion of the merits of this policy. Suffice it is to say that it has been "viewed with alarm" by a goodly number of critics, the principal objection being that it constitutes a withdrawal of assets in favor of the selling shareholder to the possible serious prejudice of creditors and remaining shareholders.[22]

R. D. K.

DOMESTIC RELATIONS

MAINTENANCE OF A BASTARD CHILD — INTERPRETATION OF OHIO GENERAL CODE, SECTION 12123

The Probate Court adjudged the defendant the putative father of a bastard child and ordered him to pay a reasonable sum for its support an maintenance, such weekly payments to begin at the date of adjudication. From this judgment the mother appealed to the Court of Appeals, contending that the weekly payments should begin at the date of birth of the child, some nineteen months prior to the date of adjudication. *Held:* Affirmed. The judgment given was the only one permissible under a strict interpretation of section 12123, Ohio G. C. One judge dissented.[1] *State* ex rel *Griffin* v. *Zimmerman*, 67 Ohio App. 272, 21 Ohio O. 253 (1941).

A review of the development of the Bastardy Act is necessary

[21] Barrett v. W. A. Webster Lumber Co., 275 Mass. 302, 175 N. E. 765 (1931); Scriggins v. Thomas Dolby Co., 290 Mass. 414, 195 N. E. 749 (1935); Spiegel v. Beacon Participations Inc. et al, 297 Mass. 398, 8 N. E. (2d) 895 (1937); Koepler v. Crocker Chair Co., 200 Wis. 476, 228 N. W. 130 (1930); Rasmussen v. Schweizer, 194 Wis. 362, 216 N. W. 481 (1927); also *see* Grace Securities Corp. v. Roberts, 158 Va. 792, 164 S. E. 700 (1932). C. F. Boggs v. Fleming, 66 Fed. (2d) 859 (C. C. A. 1933).

[22] *See* Nussbaum, *Acquisition by a Corporation of Its Own Stock*, (1935) 35 COL. L. REV. 971; Levy, *Purchase by an English Company of Its Shares*, (1930) 79 U. PA. L. REV. 45; WARREN, *Progress of the Law: Corporations*, (1921) 34 HARV. L. REV. 282, 293; Levy, *op. cit. supra*, note 20.

[1] Crow, J., dissented.